

SPEECH ON BROWN-KAUFMAN SAFE BANKING ACT

By U.S. Senator Edward E. Kaufman
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Mr. President, it is a simple proposition: We can either limit the size and leverage of “too big to fail” financial institutions now, or we will suffer the economic consequences of their potential failure later. Breaking apart too-big-to-fail banks is the necessary first step in preventing another cycle of boom-bust-and-bailout.

This debate is a test of whether the power of that idea can spread and gain support. Though it is clearly the safest way to avoid another financial crisis, this idea must overcome tremendous resistance from Wall Street banks and their politically powerful campaigns against structural financial reform.

Moreover, the idea must overcome the inertia and caution in a Congress drawn to easier ideas that may work. But how much should we gamble that they will work? Limiting size and leverage are redundant fail-safe provisions to prevent a dangerous outcome. Senator Brown and I are proposing a complementary idea, not a substitute.

The current bill has many important provisions that we support. But under its approach, we must hope the financial stability oversight council can identify systemic risks before it's too late. We must hope that regulators will be emboldened to act in a timely manner when before they failed to act. We must hope better transparency and financial data will produce early warning signals of systemic danger so clear that a council and panel of judges will unhesitatingly agree. We must hope that capital requirements will be set properly in relation to risks that all too often remain purposefully hidden from view. We must hope the resolution authority will work when we know it has no cross-border authority to resolve global financial institutions.

And under the current bill we must hope all future presidents will appoint regulators as determined to carry out the same strict measures preached belatedly by today's regulators who have been converted by the traumatic experience of their own failures.

All rules to restrict excessive risk-taking in banking have a "half-life," because the financial sector is full of smart people with an incentive to find their way around rules - particularly to load up on risk, as this is what provides them excessive profits and big bonuses.

I would rather not pin the future of the American economy on so much hope. I would rather Congress act now definitively and responsibly to end too big to fail.

The changes in regulations envisioned today would help initially, but they could quickly erode - particularly by the next free market candidate who wins the presidency and appoints regulators who only believe in self regulation.

A legislative size and leverage restriction would last far longer. Remember, the Depression era banking laws provided a foundation for financial stability for almost 50 years.

Some argue that we need massive banks, but recent studies show that over \$100 billion in assets, financial institutions no longer achieve additional economies of scale -- they simply become dangerous concentrations of financial power that benefit from an implicit government guarantee that they will be saved if they fail. With this implicit guarantee, these firms will continue to have every incentive to use massive amounts of short-term debt to finance their purchases of risky assets -- that is, until they bet wrong, cause the next crisis, and the taxpayers must bail them out again.

While \$100 billion banks would be smaller, they are not small banks -- and such banks would have no trouble competing around the world.

And, under this bill, we would still have banks far bigger than even that size. Just because other countries subsidize mega-banks that could send those countries spiraling into a financial crisis should not make us want to do the same. Most people in the oil industry did well after the break-up of Standard Oil (including its shareholders) and the break-up of AT&T helped to make the telecom industry in this country more dynamic and competitive.

As I said, the current Senate bill contains many important provisions that address the causes of the financial crisis. But why risk leaving oversized institutions in place when they are “too big to fail?” Instead we should meet the challenge of the moment and have the courage to act to limit the size and practices of these literally colossal financial institutions, the stability of which is a threat to our economy.

This bill is the best hope to ensure future decades of financial stability and the livelihoods of the American people. This bill would put the days of "too big to fail" forever behind us.